FILED

No. (1) 981271 FEB 8 1999

OFFICE OF THE CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1998

JOHN ROMANO,

*Petitioner,*

—v.—

SECURITIES AND EXCHANGE COMMISSION,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## PETITION FOR A WRIT OF CERTIORARI

RONALD E. DEPETRIS
*Counsel of Record*
DEPETRIS & BACHRACH
*Attorneys for Petitioner*
620 Fifth Avenue
New York, New York 10020
(212) 332-6030

4988

## QUESTIONS PRESENTED

1. Is manipulative intent or purpose an essential element of a claim of primary liability for market manipulation under Section 10(b) of the Securities Exchange Act of 1934?

2. Does recklessness satisfy the scienter requirement for imposition of primary liability for market manipulation under Section 10(b) of the Securities Exchange Act of 1934?

## LIST OF PARTIES

In addition to petitioner John Romano, the only other party to the appeal before the United States Court of Appeals for the Second Circuit, whose judgment is sought to be reviewed, was the Securities and Exchange Commission.

## TABLE OF CONTENTS


| | PAGE |
|---|---|
| QUESTIONS PRESENTED | i |
| LIST OF PARTIES | ii |
| TABLE OF AUTHORITIES | v |
| OPINIONS BELOW | 1 |
| STATEMENT OF JURISDICTION | 2 |
| STATUTES AND REGULATIONS INVOLVED | 2 |
| STATEMENT OF THE CASE | 4 |
| The Claim of Market Manipulation | 5 |
| The District Court's Decisions | 7 |
| The Second Circuit's Decision | 8 |
| REASONS FOR GRANTING THE WRIT | 10 |
| I. THE SECOND CIRCUIT COURT OF APPEALS HAS DECIDED AN IMPORTANT FEDERAL QUESTION CONCERNING PRIMARY LIABILITY FOR SECURITIES FRAUD IN A MANNER THAT CONFLICTS WITH DECISIONS OF THIS COURT | 10 |

PAGE

II. THE IMPORTANT FEDERAL QUESTION AS TO WHETHER RECKLESSNESS CONSTITUTES SUFFICIENT SCIENTER TO IMPOSE LIABILITY FOR MARKET MANIPULATION SHOULD BE RESOLVED BY THE SUPREME COURT ..... 14

CONCLUSION ..... 17

APPENDIX:

Opinion of the United States Court of Appeals for the Second Circuit ..... 1a

Order of the United States Court of Appeals for the Second Circuit Denying Petition for Rehearing ..... 15a

Opinion of the United States District Court for the Southern District of New York ..... 17a

Order of the United States District Court for the Southern District of New York (Certification for Interlocutory Appeal)..... 24a

## TABLE OF AUTHORITIES

**Cases:** PAGE

*Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S.Ct. 1439 (1994) ..... *passim*

*Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375 (1976) ..... 12, 13, 14, 16

*Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S.Ct. 1292 (1977) ..... 13

*S.E.C. v. U.S. Environmental, Inc.*, 897 F.Supp. 117 (S.D.N.Y. 1995) ..... 7

*S.E.C. v. U.S. Environmental, Inc.*, 929 F. Supp. 168 (S.D.N.Y. 1996) ..... 8

*S.E.C. v. U.S. Environmental, Inc.*, 155 F.3d 107 (2d Cir. 1998) ..... 1, 2, 8, 9

**Miscellaneous:**

Securities and Exchange Act of 1934:

Section 9(a), 15 U.S.C. § 78i(a) ..... 3, 4, 12

Section 10(b), 15 U.S.C. § 78j(b) ..... *passim*

Steinberg, *Securities Regulation: Liabilities and Remedies* (1998) ..... 15

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1998

**No. __-____**

JOHN ROMANO,

*Petitioner,*

—against—

SECURITIES AND EXCHANGE COMMISSION,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## PETITION FOR A WRIT OF CERTIORARI

Petitioner John Romano respectfully requests that a Writ of Certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit, entered on August 28, 1998, which reversed the memorandum order dismissing the claim of market manipulation against petitioner issued by the United States District Court for the Southern District of New York.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported as *S.E.C. v. U.S. Environmental,*

*Inc.*, 155 F.3d 107 (2d Cir. 1998). The opinion is set forth in the Appendix.

The opinion of the United States District Court for the Southern District of New York is reported as *S.E.C. v. U.S. Environmental, Inc.*, 929 F. Supp. 168 (S.D.N.Y. 1996). The opinion is set forth in the Appendix.

## STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Second Circuit was rendered on August 28, 1998. A petition for rehearing containing a suggestion for rehearing *en banc* was denied on November 13, 1998. The jurisdiction of this Court to review the judgment by writ of certiorari is invoked pursuant to 28 U.S.C. § 1254.

## STATUTES AND REGULATIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5, provides:

> Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 9(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78i(a), provides:

> Manipulation of security prices
>
> Transactions relating to purchase or sale of security
> (a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—
>
> (1) For the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security, (A) to effect any transaction in such security which involves no change in the beneficial ownership thereof, or (B) to enter an order or orders for the purchase of such security with the knowledge that an order or orders

of substantially the same size, at substantially the same time, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties, or (C) to enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

## STATEMENT OF THE CASE

This case presents important questions concerning the essential elements of a claim of primary liability for market manipulation under Section 10(b) of the Securities Exchange Act of 1934. In its decision reversing the district court, the Second Circuit Court of Appeals ruled that a stock trader may be held primarily liable for manipulation of the market even though the trader did not act with a manipulative purpose or intent and did not share the manipulative purpose or intent of the principal defendants, the stock promoters. The case is extraordinary because the Second Circuit reached this rather remarkable conclusion on a significant issue without citing a single case holding that manipulative purpose or intent is not an essential element of a manipulation claim, and without addressing decisions by this Court that belie the proposition that a person may be liable for market manipulation without regard to manipulative intent or purpose.

The Court of Appeals reversed a decision of the United States District Court for the Southern District of New York (Leisure, J.), which had granted a motion by petitioner John Romano ("Romano") to dismiss the claim for market manipulation in the Amended Complaint brought by plaintiff Securities and Exchange Commission ("SEC"). The claim against Romano had been dismissed by the district court for failure to state a claim of primary liability under *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S.Ct. 1439 (1994). As Judge Leisure stated in certifying his order for interlocutory review:

> The Amended Complaint alleged knowledge or recklessness on the part of defendant Romano, whereas this Court has ruled that intent was required before a trade could be designated manipulative. . . . Specifically, the Court . . . has ruled that where, as here, manipulation is the basis of the claim, manipulative intent, and not mere knowledge or recklessness, is required before Rule 10b-5 is violated.

Appendix, at p. 25a.

The facts and circumstances material to the consideration of the questions presented on this petition are set forth below under appropriate headings.

**The Claim of Market Manipulation**

The Amended Complaint alleges that eleven defendants participated in various schemes to defraud relating to the stock of U.S. Environmental, Inc. ("USE"), most of which do not involve the stock trader Romano. The central participants in the alleged schemes are the stock promoters, collectively referred to as the "D'Onofrio group". Amended Complaint, at ¶¶ 12, 13, 26. The SEC invoked the jurisdiction of the district court pursuant to 15 U.S.C. § 77v(a) and 15 U.S.C. §§ 78u(e), 78aa. Amended Complaint, at ¶ 9.

Significantly, the Amended Complaint alleges that it was the D'Onofrio group—not Romano—that engaged in manipulative devices referred to as "wash sales" and "matched orders". Amended Complaint, at ¶ 81. The gravamen of the manipulation scheme is described in paragraphs 81 and 86 of the Amended Complaint as follows:

> 81. On a significant number of trading days between in or about September and December 1989, the D'Onofrio group engaged in manipulative devices that had the effect of transferring shares from one D'Onofrio group controlled account to another D'Onofrio group controlled account at successively higher prices, as well as giving the false appearance of demand for USE shares. These manipulative devices, which included prearranged simultaneous "buy" and "sell" orders, are referred to as "wash sales" and "matched orders".
>
> . . .
>
> 86. In order to effect the "wash sales" and "matched orders," the D'Onofrio group utilized approximately 43 brokerage accounts it controlled in several brokerage firms located in Canada, as well as approximately 3 accounts maintained at Castle. Most of these accounts were in the names of nominees.

Romano is alleged to have participated in this trading in his position as a trader for the market maker Castle Securities Corp. Amended Complaint, at ¶¶ 82-85, 87-88. The Amended Complaint does not allege that D'Onofrio ever told Romano that the D'Onofrio group controlled these numerous nominee accounts and that the D'Onofrio group was employing "wash sales" and "matched orders" through these accounts, let alone particularize a factual basis to support such allegations. Instead the Amended Complaint alleges in conclusory fashion that the D'Onofrio group, Castle Securities Corp., its principal Michael Studer, and Romano intentionally engaged in such conduct. As to Romano, it alleges that he "knew, or was

reckless in not knowing, that the D'Onofrio group controlled the overwhelming majority of trades in USE during this period of time." Amended Complaint, at ¶¶ 84, 87, 88. Referring to the guaranteed profit protection allegedly prearranged by D'Onofrio with Castle Securities Corp. and its principal Studer, the Amended Complaint also alleges that Romano "knew, or was reckless in not knowing, of" this arrangement and that the prices of USE securities were being manipulated. Amended Complaint, at ¶ 78.

The stock promoter Mark D'Onofrio has pled guilty to criminal charges and cooperated with the government and the SEC in this matter. Thus, the complete absence of any allegation that D'Onofrio ever told Romano that the D'Onofrio group controlled the numerous nominee accounts utilized to effect the "wash sales" and "matched orders" or that the D'Onofrio group was in effect on both sides of the transactions is both striking and telling. It is no wonder, then, that in pleading its claim of market manipulation against Romano, the SEC does not allege that Romano acted with the specific intent to manipulate the market. Instead the SEC alleges that "defendant Romano knowingly or recklessly participated in and furthered a market manipulation by" effecting the trades prearranged by the D'Onofrio group. Amended Complaint, at ¶ 145.

**The District Court's Decisions**

The Amended Complaint was the SEC's second attempt to state a manipulation of the market claim against Romano. The district court dismissed this claim as alleged in the initial complaint for failure to state a claim of primary liability and for failure to plead fraud with particularity. *S.E.C. v. U.S. Environmental, Inc.*, 897 F.Supp. 117, 121 (S.D.N.Y. 1995). Judge Leisure dismissed this third claim for relief in the Amended Complaint for failure to state a claim of primary liability, and did not address the alternative ground that the fraud alleged in the manipulation claim was not pled with par-

ticularity. *S.E.C. v. U.S. Environmental, Inc.*, 929 F.Supp. 168, 171 (S.D.N.Y. 1996).

After noting that the SEC alleged that Romano was liable for manipulating the market based on his execution of trades at the direction of D'Onofrio "with knowledge or with reckless disregard of the fact that the trades were manipulative", the district court ruled that Romano cannot be held liable as a primary violator because "Romano did not 'employ' a manipulative device, but merely executed elements of the manipulative trades of D'Onofrio". *Id.*, at 170. The district court held that "[e]ven if Romano . . . knew that D'Onofrio was manipulating USE stock, he [Romano] did not himself manipulate USE stock because he did not himself have a manipulative purpose." *Id.* The gravamen of Judge Leisure's decision was that without employing a manipulative intent or purpose Romano could not be primarily liable. *Id.*, at 170-71. Thus, the district court held that the allegations against Romano "constitute nothing more than aiding and abetting manipulation, and hence are not actionable under § 10(b) of the Exchange Act." *Id.*, at 171.

The memorandum order dismissing the claim was certified for interlocutory appeal by the district court, and the Court of Appeals granted permission for the SEC to appeal.

**The Second Circuit's Decision**

At the very outset of its decision, the Court of Appeals set forth its ruling as follows: "We hold that Romano can be primarily liable under § 10(b) for following a stock promoter's directions to execute trades that Romano knew, or was reckless in not knowing, were manipulative, even if Romano did not share the promoter's specific overall purpose to manipulate the market for that stock." *S.E.C. v. U.S. Environmental, Inc.*, 155 F.3d 107, 108 (2d Cir. 1998). The panel restated this holding later in its decision as follows:

> Romano's principal contention on this appeal, with which the district court agreed, is that he cannot be primarily liable under § 10(b) for following a stock promoter's directions to execute trades that Romano knew, or was reckless in not knowing, were manipulative, where Romano did not share the promoter's ultimate 'manipulative . . . purpose' to raise the stock price. We disagree.

*Id.*, at 110.

The main basis for the panel's ruling appears to be its view that the requisite level of scienter (whether specific intent to manipulate, knowledge or recklessness) is irrelevant to the determination of primary liability under *Central Bank*. The panel stated that "whether Romano was a primary violator rather than an aider and abettor turns on the nature of his acts, not on his state of mind when he performed them." *Id.*, at 111. Thus, the panel concluded that allegations that Romano participated in the fraudulent scheme by effecting the trades that artificially manipulated the stock's price upward at the promoter's direction were sufficient to state a claim of primary liability, even if Romano did not act with or share the promoter's manipulative purpose or intent of artificially affecting the price. *Id.*, at 111, 112. The panel also held alternatively that knowledge or recklessness constituted sufficient scienter to state a claim of liability under § 10(b) for market manipulation. *Id.*, at 111-12.

## REASONS FOR GRANTING THE WRIT

### I.

### THE SECOND CIRCUIT COURT OF APPEALS HAS DECIDED AN IMPORTANT FEDERAL QUESTION CONCERNING PRIMARY LIABILITY FOR SECURITIES FRAUD IN A MANNER THAT CONFLICTS WITH DECISIONS OF THIS COURT

The district court properly held that a manipulative purpose or intent is an essential element of a claim of primary liability for market manipulation. The Second Circuit's decision to the contrary is fundamentally flawed because it relies on an overbroad reading of this Court's decision in *Central Bank* that is belied by the language in *Central Bank* itself. The ruling also conflicts with other decisions of this Court concerning the definition of manipulation. Simply put, a person who participates in trading that furthers another's manipulation—but does not act in concert with and share that person's manipulative purpose—is at most an aider and abettor, not a primary violator.

In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., supra*, this Court held that private civil liability under the general antifraud provisions of the Securities Exchange Act of 1934 does not extend to those who aid and abet the manipulative or deceptive acts prohibited by § 10(b) of the statute. Holding that the text of the statute controls the decision as to the scope of the conduct prohibited by § 10(b), the Supreme Court refused to entertain claims for conduct not prohibited by the text. *Id.*, 511 U.S. at 173, 177, 114 S.Ct. at 1446, 1448.

In *Central Bank* this Court set forth the parameters of liability under § 10(b). The Supreme Court ruled:

> we again conclude that the statute prohibits only the making of a material misstatement (or omission) or the

> commission of a manipulative act. . . . The proscription does not include giving aid to a person who commits a manipulative or deceptive act.
>
> . . .
>
> Because the text of § 10(b) does not prohibit aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under § 10(b). The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity . . . who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.

*Id.*, 511 U.S. at 177, 191, 114 S.Ct. at 1448, 1455.

The Second Circuit's view that a stock trader may be liable for market manipulation as a primary violator without regard to manipulative intent or purpose ignores significant qualifying language in the *Central Bank* decision itself. In discussing the circumstances under which a secondary actor may be primarily liable for manipulation, the Supreme Court ruled as follows: "Any person . . . who employs a manipulative device . . . may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met" (emphasis in original). *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., supra*, 511 U.S. at 191, 114 S.Ct. at 1455. Thus, this Court made clear that even a secondary actor who employs a manipulative device is not liable unless *all* the requirements for primary liability are met. As we show below, one of those requirements is a manipulative intent or purpose. Accordingly, whether the language "employs a manipulative device" is read

broadly or not, it does not dispense with the requirement of a manipulative intent or purpose.

We note first that the Second Circuit's broad reading of this language ignores the specific terms used by Congress in the statute. The word "manipulative" as used in the securities laws is virtually a term of art that connotes conduct performed with a manipulative intent or purpose. In light of this meaning, it makes no sense to argue that a person can "employ" a "manipulative" device even though he does not have a manipulative purpose or intent. *Cf. Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199, text and n.20, n.21, 96 S.Ct. 1375, 1384 (1976) (observing that the SEC's arguments ignore Congress' use of the words "manipulative" and "employ"). Thus, as the district court properly concluded, a trader does not "employ" a "manipulative" device if he does not have a manipulative purpose or intent.

At all events, the Second Circuit's ruling that a manipulative purpose or intent is not an essential element of a market manipulation claim is in conflict with the definition of manipulation contained in decisions of this Court, and the statutory definition of manipulation contained in Section 9(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78i(a). In *Ernst & Ernst v. Hochfelder*, *supra*, 425 U.S. at 205, n.25, 96 S.Ct. at 1386, this Court defined the terms "wash sales" and "matched orders", the very manipulative devices that form the gravamen of the SEC's claim against Romano herein. Significantly, rather than dispensing with the element of manipulative intent or purpose, this Court noted that Section 9(a)(1) of the Exchange Act "proscribes wash sales and matched orders when effectuated '[f]or the *purpose of creating a false or misleading appearance of active trading* in any security registered on a national securities exchange, or . . . with respect to the market for any such security.' " (Emphasis added in internal quote from the statute.) *Id.*, 425 U.S. at 205, n.25, 96 S.Ct. at 1386-87. Moreover, with respect to Congress' use of the word "manipulative" in Section 10(b),

this Court stated that the word "is and was virtually a term of art when used in connection with securities markets. It connotes *intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities*" (emphasis added). *Id.*, 425 U.S. at 199, 96 S.Ct. at 1384.

Similarly, in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476, 97 S.Ct. 1292, 1302 (1977), this Court once again noted that the word "manipulation" is "virtually a term of art when used in connection with securities markets" (quoting from *Hochfelder*). This Court further stated: "The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are *intended to mislead investors by artificially affecting market activity*". (Emphasis added.) *Id.*, 430 U.S. at 476, 97 S.Ct. at 1302. In reversing the Second Circuit and holding that the complaint failed to allege "manipulative" conduct within the meaning of Section 10(b), this Court ruled that Congress would not have chosen this "term of art" if it had intended the scope of liability under Section 10(b) for "manipulative" conduct to encompass conduct that did not fall within this meaning. *Id.*, 430 U.S. at 476-77, 97 S.Ct. at 1302-03. Yet in the case at bar the Second Circuit ruled that Romano may be held primarily liable for market manipulation even if he did not have this "manipulative" intent or purpose.

Accordingly, we respectfully submit that certiorari should be granted here to resolve these conflicts between the Second Circuit's decision and the decisions of this Court, and to address the important federal question as to whether manipulative intent or purpose is an essential element of a claim of primary liability for market manipulation.

## II.

## THE IMPORTANT FEDERAL QUESTION AS TO WHETHER RECKLESSNESS CONSTITUTES SUFFICIENT SCIENTER TO IMPOSE LIABILITY FOR MARKET MANIPULATION SHOULD BE RESOLVED BY THE SUPREME COURT

In this case the Court of Appeals not only reversed the district court's holding that a manipulative intent or purpose was an essential element of a claim of primary liability for market manipulation. In addition, the Second Circuit ruled that recklessness constituted sufficient scienter to impose primary liability on the secondary actor Romano for market manipulation. For the reasons set forth below, we respectfully submit that this important federal question concerning the requisite level of scienter should be resolved by the Supreme Court.

In *Ernst & Ernst v. Hochfelder*, *supra*, this Court granted certiorari "to resolve the question whether a private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the absence of any allegation of 'scienter'—intent to deceive, manipulate, or defraud." *Id.*, 425 U.S. at 193, 96 S.Ct. at 1381. The Court went on to hold that scienter was required, and that liability could not be imposed for negligent conduct.

However, this Court expressly left open the question of whether recklessness would suffice to constitute scienter:

> In this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud. In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5.

*Id.*, 425 U.S. at 193, n.12, 96 S.Ct. at 1381.

Most of the circuits have since held that recklessness can constitute sufficient scienter to impose liability for the making of a material misstatement. See, e.g., Steinberg, *Securities Regulation: Liabilities and Remedies*, § 7.02, at pp. 7- 8, 7-9 (1998). Similarly, most of the circuits had held that there was an implied cause of action for aiding and abetting violations of Section 10(b) and Rule 10b-5. *Id.*, § 10.02, at p. 10-3. In the *Central Bank* case itself, the Tenth Circuit had held that recklessness was sufficient scienter to hold a secondary actor liable for aiding and abetting the primary violator. See *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, *supra*, 511 U.S. at 168-69, 114 S.Ct. at 1443-44.

In *Central Bank*, this Court granted certiorari to review two important questions presented: "(1) Is there implied private right of action for aiding and abetting violations of Section 10(b) of 1934 Securities Exchange Act and SEC Rule 10b-5? (2)Does recklessness satisfy scienter requirement for aiding and abetting even when there is no breach of duty to disclose or to act?" 61 U.S.L.W. 3813-14 (U.S. June 8, 1993). In its decision in *Central Bank*, this Court did not decide the second important question because it held that a private plaintiff may not maintain an aiding and abetting claim under Section 10(b).[1]

Thus, the issue as to whether recklessness is sufficient to satisfy the scienter requirement is still an open one in the Supreme Court. Moreover, by granting certiorari on this issue in *Central Bank*, this Court has already indicated that the question is worthy of review by the Supreme Court.

---

[1] As commentators have noted, in rejecting the SEC's argument premised on the criminal aiding and abetting statute, the Supreme Court hinted that "recklessness" as opposed to "intentional wrongdoing" might not be an acceptable basis for imposing liability. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, *supra*, 511 U.S. at 190, 114 S.Ct. at 1454- 55.

As was the case with respect to aiding and abetting liability, the courts of appeals which have held that recklessness satisfies the element of scienter have ignored or disregarded a critical point: "the text of the statute controls" the decision as to the "scope of conduct prohibited by § 10(b)" (*id.*, 511 U.S. at 173, 114 S.Ct. at 1446).[2] As was true in *Central Bank*, that critical point "bodes ill" (*id.*, 511 U.S. at 175, 114 S.Ct. at 1447) for the Second Circuit's ruling here, because the text of Section 10(b) does not in terms mention recklessness. Moreover, as already noted, the term "manipulative" "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst v. Hochfelder*, *supra*, 425 U.S. at 199, 96 S.Ct. at 1384. Thus, the statutory text strongly suggests that recklessness is not sufficient to satisfy the scienter requirement for a market manipulation claim. Since the statutory text is controlling, the rationale of *Hochfelder* and *Central Bank* lead inevitably to the conclusion that recklessness is not sufficient to establish primary liability for market manipulation under Section 10(b).

---

[2] The Second Circuit's decision in the case at bar compounded this problem by ignoring the circumstance that the cases in which the courts of appeals ruled that recklessness was sufficient did not involve claims of market manipulation.

## CONCLUSION

For the reasons stated herein, the petition for a writ of certiorari should be granted.

Dated: February 5, 1999

Respectfully submitted,

RONALD E. DEPETRIS
*Counsel of Record*
DEPETRIS & BACHRACH
*Attorneys for Petitioner*
620 Fifth Avenue
New York, New York 10020
(212) 332-6030

# APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

---

August Term 1997

(Argued April 23, 1998 Decided August 28, 1998)

Docket No. 97-6195

---

SECURITIES AND EXCHANGE COMMISSION,

*Plaintiff-Appellant*,

—v.—

U.S. ENVIRONMENTAL, INC.; LOUIS J. SEPE; MARIA SEPE; CASTLE SECURITIES CORP.; MICHAEL T. STRUDER; LESLIE S. ROTH; and DUDLEY MIHRAN FREELAND,

*Defendants*,

JOHN ROMANO,

*Defendant-Appellee*.

---

Before:

WALKER, CALABRESI, *Circuit Judges*, and RESTANI, *Judge*.*

---

* The Honorable Jane A. Restani, of the United States Court of International Trade, sitting by designation.

Plaintiff-appellant Securities and Exchange Commission appeals from the June 18, 1996 order of the United States District Court for the Southern District of New York (Peter K. Leisure, *District Judge*) dismissing, pursuant to Fed. R. Civ. P. 12(b)(6), the SEC's claim that defendant-appellee John Romano engaged in market manipulation in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

Vacated and remanded.

---

RICHARD H. WALKER, General Counsel (Jacob H. Stillman, Associate General Counsel, Lucinda O. McConathy, Assistant General Counsel, Christopher Paik, Senior Counsel, Paul Gonson, Solicitor, Securities and Exchange Commission, Washington, D.C., on the brief), for *Plaintiff-Appellant*.

RONALD E. DEPETRIS, DePetris & Bachrach, New York, New York, for *Defendant-Appellee*.

---

WALKER, *Circuit Judge*:

Plaintiff-appellant Securities and Exchange Commission ("SEC") appeals from the June 18, 1996 order of the United States District Court for the Southern District of New York (Peter K. Leisure, *District Judge*) dismissing, pursuant to Fed. R. Civ. P. 12(b)(6), the SEC's claim that defendant-appellee John Romano engaged in

market manipulation in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) ("§ 10(b)"), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 ("Rule 10b-5").

We hold that Romano can be primarily liable under § 10(b) for following a stock promoter's directions to execute stock trades that Romano knew, or was reckless in not knowing, were manipulative, even if Romano did not share the promoter's specific overall purpose to manipulate the market for that stock. We therefore vacate the order of the district court and remand for further proceedings.

*Background*

The following facts are taken exclusively from the SEC's amended complaint, which on a motion to dismiss at the pleading stage must be read in the light most favorable to the SEC.

Romano was employed as a trader and registered representative of defendant Castle Securities Corporation ("Castle"), a securities broker-dealer. Castle agreed to participate in a scheme whereby it and other defendants, including Romano, would manipulate upward the price of the stock of U.S. Environmental, Inc. ("USE"). At the direction of stock promoter Mark D'Onofrio ("D'Onofrio"), certain of the defendants or their nominees traded USE shares among themselves "for the purpose of creating the appearance of an actual market for trading USE shares" and thus raising USE's stock price. The complaint alleges that

> Romano knowingly or recklessly participated in and furthered a market manipulation by:

(a) effecting offers, purchases, and sales of USE securities in return for promises of risk-free profit for engaging in such trades;

(b) effecting directed and controlled trades of USE securities;

(c) effecting "wash sales" and "matched orders"; and

(d) effecting trades involving undisclosed nominees.

Wash sales are "transactions involving no change in beneficial ownership" and matched orders are "orders for the purchase [or] sale of a security that are entered with the knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale/purchase of such security." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 205 n.25 (1976). The complaint states further that

> Romano agreed to advise D'Onofrio continuously as Castle received buy and sell orders for USE shares during each trading day. Romano agreed to execute trades as directed by D'Onofrio, and Romano also agreed to move, or adjust, the price Castle quoted for USE shares at D'Onofrio's direction. In return, D'Onofrio assured Romano that Castle would receive a profit on the transactions D'Onofrio directed.

In a typical manipulative transaction,

> (a) D'Onofrio would direct a buy order from one of the . . . brokerage accounts controlled by the D'Onofrio group [consisting of stock promoters

> Ramon N. D'Onofrio, Richard Kirschbaum, and D'Onofrio] to a market maker other than Castle;
>
> (b) D'Onofrio would arrange in advance that the other market maker would contact Romano at Castle to buy the same number of shares;
>
> (c) D'Onofrio would alert Romano that the other market maker would be calling Romano for stock;
>
> (d) D'Onofrio, specifying number of shares and price, would instruct Romano to sell shares of USE to the other market maker; and
>
> (e) D'Onofrio would supply Castle with the specified number of shares at a discount, enabling Romano to complete the transaction at a price at which both Castle and the other market maker received a risk-free profit on the transaction, as had been prearranged with Castle . . . and Romano.

Romano, Castle, and the D'Onofrio group "intentionally engaged" in such "manipulative conduct . . . between September 1989 and December 1989." As a result of these manipulative trades, the price of USE stock rose from $.05 to approximately $5.00 per share in this period. In June or early July 1990, Castle sold approximately 15,000 shares of USE stock to retail customers at $6.00 per share. Between September 1989 and August 1990, Castle made a profit of approximately $175,000 as a result of its market-making activity for USE.

The SEC then commenced the instant action, alleging that defendants violated various provisions of the securities laws in connection with their manipulation of USE stock and other aspects of an illegal scheme involving USE. Romano moved, pursuant to Fed R. Civ. P. 12(b)(6), to dismiss the SEC's manipulation claim under

Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The district court granted the motion, *see SEC v. U.S. Envtl., Inc.*, 929 F. Supp. 168, 171 (S.D.N.Y. 1996), on the sole ground that the SEC had failed to allege that Romano was a "primary violator[ ]," as required by the Supreme Court in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994). Rather, the district court held that Romano was alleged only to be an aider/abettor of securities violations, because Romano "follow[ed] directions from D'Onofrio in carrying out buy or sell orders" and "did not himself make wash sales, match orders, or use undisclosed nominees to artificially affect the price of securities." *U.S. Envtl.*, 929 F. Supp. at 170. The district court stated that "[e]ven if Romano knew that [the buyers and sellers] were D'Onofrio and undisclosed nominees of D'Onofrio, and hence knew that D'Onofrio was manipulating USE stock, he did not himself manipulate USE stock because he did not himself have a manipulative purpose." *Id.* In a subsequent order certifying for interlocutory appeal "[t]he issue of what level of scienter is required before a person trading in securities can be said to manipulate the securities," the district court noted that "where . . . manipulation is the basis of the claim, manipulative intent, and not mere knowledge or recklessness, is required before Rule 10b-5 is violated." *SEC v. U.S. Envtl., Inc.*, No. 94 Civ. 6608, at 1-3 (S.D.N.Y. Aug. 6, 1996). On August 25, 1997, this court granted the SEC's motion for an interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

*Discussion*

In reviewing the district court's dismissal of the SEC's claim pursuant to Fed. R. Civ. P. 12(b)(6), we are

"required to accept the material facts alleged in the complaint as true" and will vacate the dismissal "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of [its] claim which would entitle [it] to relief." *Easton v. Sundram*, 947 F.2d 1011, 1014-1015 (2d Cir. 1991) (quotation marks omitted). Our review is *de novo*. *See Leeds v. Meltz*, 85 F.3d 51, 53 (2d Cir. 1996).

Romano's principal contention on appeal, with which the district court agreed, is that he cannot be primarily liable under § 10(b) for following a stock promoter's directions to execute trades that Romano knew, or was reckless in not knowing, were manipulative, where Romano did not share the promoter's ultimate "manipulative . . . purpose" to raise the stock price. We disagree.

Under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j,

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe.[1]

---

[1] Rule 10b-5, in turn, states that

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

*(footnote continued)*

In *Central Bank*, the Supreme Court held that private civil liability under § 10(b) applies only to those who "engage in the manipulative or deceptive practice," but not to those "who aid and abet the violation." 511 U.S. at 167. The Court observed that "[a]iding and abetting is a method by which courts create secondary liability in persons *other than* the violator [or violators] of the statute." *Id.* at 184 (quotation marks omitted) (emphasis added). We have noted further that a primary violator is one who "participated in the fraudulent scheme" or other activity proscribed by the securities laws. *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1471 (2d Cir. 1996), *cert. denied*, 118 S. Ct. 57 (1997).

Under the foregoing standards, we believe that, as alleged in the complaint, Romano falls well within the boundaries of primary liability. As an initial matter, we disagree with the district court's view that "[e]ven if Romano knew that [the buyers and sellers] were D'Onofrio and undisclosed nominees of D'Onofrio, and hence knew that D'Onofrio was manipulating USE stock, [Romano] did not himself manipulate USE stock because he did not himself have a manipulative purpose." *U.S. Envtl.*, 929 F. Supp. at 170. This view conflates the distinction drawn in *Central Bank* between primary violators and aiders/abettors based on conduct with the separate issue of scienter. We have noted that

> [t]he Supreme Court in *Central Bank* did not in any way rely on the level of scienter at issue, but on the

---

(a) To employ any device, scheme, or artifice to defraud,

. . . . [or]

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

> fact that aiding and abetting was not included within the terms of [the Securities Exchange Act of 1934].
>
> . . . .
>
> [The] Court held that aiding and abetting claims fall outside of the scope of § 10(b) altogether, without drawing any distinction between claims requiring intent and claims requiring only recklessness

or some other level of scienter. *Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin*, 135 F.3d 837, 843-44 (2d Cir. 1998). Thus, whether Romano was a primary violator rather than an aider and abettor turns on the nature of his acts, not on his state of mind when he performed them.

A. *Scienter*

Of course, to establish Romano's liability under § 10(b), the complaint must as a threshold matter allege that Romano acted with sufficient scienter. *See Chill v. General Elec. Co.*, 101 F.3d 263, 266 (2d Cir. 1996). The complaint's allegation that Romano "knowingly or recklessly participated in and furthered a market manipulation by . . . effecting 'wash sales' and 'matched orders' " and that he "intentionally engaged" in "manipulative conduct" is plainly sufficient to satisfy that requirement. It is well-settled that knowledge of the proscribed activity is sufficient scienter under § 10(b). *See Ernst & Ernst*, 425 U.S. at 197 ("[t]he words 'manipulative or deceptive' . . . strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct"); *First Jersey Secs.*, 101 F.3d at 1467 ("knowing misconduct" sufficient to establish liability under securities fraud statutes); *SEC v. Lorin*, 76 F.3d 458, 460 (2d Cir. 1996) (per curiam) (affirming liability against defendant who "knew of the manipulation agreement and

knowingly participated in carrying it out"); *cf.* Restatement (Second) of Torts, § 8A (1965) ("If the actor knows that the consequences are certain, or substantially certain, to result from his act, and still goes ahead, he is treated by the law as if he had in fact desired to produce the result."). Therefore, the allegation that Romano executed trades that he knew were for a manipulative purpose sufficiently alleged scienter in a manner supporting § 10(b) liability.

Although we need not rely on this point, we also note that the complaint's claim that Romano recklessly participated in the manipulation also alleges sufficient scienter. *See San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 813 (2d Cir. 1996) ("In order to establish scienter . . . , [it is sufficient that] the plaintiffs . . . identify circumstances indicating conscious or reckless behavior by the defendants"); *Chill*, 101 F.3d at 267; *see also* Louis Loss & Joel Seligman, Securities Regulation, Vol. VIII, ch.9, § B(6), at 3665-67 n.521 (3d ed. 1991) (noting holdings of eleven circuits that recklessness can constitute sufficient scienter); *cf. Ernst & Ernst*, 425 U.S. at 193 n.12 (leaving open question whether "reckless behavior" is sufficient to establish § 10(b) liability).

Moreover, as long as Romano, with scienter, effected the manipulative buy and sell orders, Romano's personal motivation for manipulating the market is irrelevant in determining whether he violated § 10(b). Even if Romano were motivated by a desire to obtain compensation rather than by a desire to change USE's market price, as D'Onofrio was, Romano is liable under § 10(b) if, with scienter, he effected the manipulative trades.

B. *Primary Violator or Aider and Abettor*

It is plain to us that the complaint alleged Romano to be a primary violator. Romano "participated in the fraudulent scheme," *First Jersey Secs.*, 101 F.3d at 1471, *i.e.*, the manipulation of USE's stock, by effecting the very buy and sell orders that artificially manipulated USE's stock price upward. Indeed, if the trader who executes manipulative buy and sell orders is not a primary violator, it is difficult to imagine who would remain liable after *Central Bank*.

In *Central Bank*, holders of defaulted bonds sued the issuer and others alleging primary liability under Rule 10b-5 and also sued the indenture trustee on the theory that the trustee aided and abetted the other defendants' violations by recklessly ignoring its oversight duties. The Supreme Court held that § 10(b) "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act," 511 U.S. at 177, and it dismissed the claim against the trustee, who had done neither. Similarly, *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1997), involved an accounting firm that allegedly aided and abetted a fraudulent omission by "preparing [ ] financial projections that were later included in the principal defendants' offering memoranda," which in turn failed to disclose that one of the principals was a convicted felon. *Id.* at 721. We held in *Shapiro* that the accounting firm was not primarily liable, because "there exist[ed] no allegation that [its] projections misrepresented any financial fact" and the accounting firm in that case had no legal duty to disclose the information omitted from the offering memoranda. *Id.* at 721-22.

Romano, in contrast, did not simply fail to disclose information when there was no duty to do so, as in *Shapiro*, or fail to prevent another party from engaging

in a fraudulent act, as in *Central Bank*, when there existed no duty to prevent such. Rather, Romano himself "commi[tted] a manipulative act," *Central Bank*, 511 U.S. at 177, by effecting the very buy and sell orders that manipulated USE's stock upward.

Finally, it is of no relevance that D'Onofrio, not Romano, masterminded the USE stock manipulation and that D'Onofrio's group "directed" Romano to effect the illegal trades.

> The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device . . . may be liable as a primary violator under 10b-5 . . . . In any complex securities fraud, moreover, there are likely to be multiple violators. . . .

*Central Bank*, 511 U.S. at 191. Like lawyers, accountants, and banks who engage in fraudulent or deceptive practices at their clients' direction, Romano is a primary violator despite the fact that someone else directed the market manipulation scheme. The Supreme Court in *Central Bank* never intended to restrict § 10(b) liability to supervisors or directors of securities fraud schemes while excluding from liability subordinates who also violated the securities laws. In sum, the complaint alleges that Romano is primarily liable under § 10(b) and Rule 10b-5 for the manipulation of USE stock.

Finally, in concluding, we make a few observations. First, in granting Romano's motion to dismiss, the district court dismissed the amended complaint's "third claim for relief—that Romano violated § 10(b) . . . and

Rule 10b-5." *U.S. Envtl.*, 929 F. Supp. at 171. Although the amended complaint's third claim was brought under Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) ("§ 17(a)"), as well as under § 10(b) and Rule 10b-5, neither the district court's opinion nor its certification order mention § 17(a). We also note that neither the SEC nor Romano has addressed § 17(a) on appeal. We conclude, therefore, that the district court did not dismiss the SEC's third claim under § 17(a), and we do not address § 17(a) in this opinion.

Second, we note that, although Romano suggests that the complaint fails to allege Romano's fraud with particularity as required by Fed. R. Civ. P. 9(b), *see* Appellee's Br. at 6-7, the district court explicitly declined to rule upon that issue, *see U.S. Envtl.*, 929 F. Supp. at 171, and did not certify that issue for appeal. We therefore are without jurisdiction to consider the point.

Third and last, we note that The Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67 ("Reform Act"), enacted after *Central Bank*, provides that, in SEC actions, "any person that knowingly provides substantial assistance to another person in violation of a provision of [15 U.S.C. Chapter 2B, which includes § 10(b)], or of any rule or regulation issued under this chapter [including Rule 10b-5], shall be deemed to be in violation of such provision to the same extent as the person to wnom such assistance is provided." 15 U.S.C. § 78t(f). Thus, unlike private plaintiffs, the SEC now has authority to assert aiding and abetting claims under § 10(b). *See id.*; *SEC v. Fehn*, 97 F.3d 1276, 1283 (9th Cir. 1996), *cert. denied*, 118 S. Ct. 59 (1997). It remains unclear, however, whether the SEC could bring aiding/abetting claims in cases based on

conduct occurring prior to the enactment of the Reform Act. *See id.* at 1286-87 (applying Reform Act retroactively under particular circumstances of that case). Because the SEC did not make this argument before the district court or on appeal, however, we do not address this alternate ground for vacating the district court's dismissal. *See* Fed. R. App. P. 28(a)(6); *LoSacco v. City of Middletown*, 71 F.3d 88, 92 (2d Cir. 1995) (arguments not addressed in appellate brief are waived).

*Conclusion*

For the reasons set forth above, the order of the district court is vacated and remanded. Each party shall bear its own costs.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

---

Dkt No: 97-6195
Filed: Nov. 13, 1998

---

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the _____ day of _____ one thousand nine hundred and ninety-eight.

---

SEC

—v—

U.S. ENVIRONMENTAL

---

A petition for rehearing containing a suggestion that the action be *reheard* in banc having been filed herein by the appellee JOHN ROMANO.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular

active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

CAROLYN CLARK CAMPBELL, Clerk

By: BETH J. MEADOR
Beth J. Meador,
Administrative Attorney

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

---

94 Civ. 6608 (PKL)

---

SECURITIES AND EXCHANGE COMMISSION,

*Plaintiff,*

—against—

U.S. ENVIRONMENTAL, INC., et al.,

*Defendants.*

---

MEMORANDUM ORDER

LEISURE, *District Judge*:

Before the Court is defendant John Romano's motion to dismiss claims in the Amended Complaint pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6). Specifically, Romano moves to dismiss (i) plaintiff's third claim for relief—that Romano violated § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder by manipulating the market for U.S. Environmental ("USE") stock—for failure to state a claim and for failure to plead fraud with particularity; and (ii) plaintiff's sixth claim for relief—that Romano violated § 10(b) of the Exchange Act and Rule 10b-6 promulgated thereunder by purchasing or bidding on a security while he was a participant in the distribution of that security—for failure to plead fraud with particularity. For

the reasons stated below, the motion to dismiss is granted as to plaintiff's third claim for relief and denied as to plaintiff's sixth claim for relief.

## BACKGROUND

This is an action for federal securities laws violations. The Securities and Exchange Commission (the "SEC") alleges that defendants participated in schemes to defraud relating to USE stock. Romano was a trader and registered representative at defendant Castle Securities Corp. ("Castle"), a broker-dealer whose business is alleged to have consisted principally of retail securities brokerage, underwriting, and market-making activities. Romano was named in the first, third, fifth, and sixth claims for relief in the original Complaint. The Court, by Memorandum Order dated August 24, 1995, granted Romano's motion to dismiss plaintiff's first, third, and sixth claims for relief. *See S.E.C. v. U.S. Environmental, Inc.*, 897 F. Supp. 117 (S.D.N.Y. 1995) (Leisure, J.). The Court dismissed plaintiff's first claim for relief—that Romano and others conspired to violate various securities laws—with prejudice. The Court dismissed the third and sixth claims for relief, but granted plaintiff leave to replead. Plaintiff filed its Amended Complaint on October 20, 1995, and Romano again moved to dismiss.

## DISCUSSION

### I. *Romano's Motion to Dismiss Third Claim (Manipulation in Violation of Rule 10b-5) Based on Fed. R. Civ. P. 12(b)(6)*

The third claim for relief alleges that Romano violated Rule 10b-5, 17 C.F.R. § 240.10b-5, by manipulating the market in USE stock, by executing trades that were wash sales[1] at the

[1] " 'Wash' sales are transactions involving no change in beneficial ownership. 'Matched' orders are orders for the purchase/sale of a security that are entered with the knowledge that orders of substantially the

direction of defendant Mark D'Onofrio ("D'Onofrio"), with knowledge or with reckless disregard of the fact that the trades were manipulative. Romano moves to dismiss, pursuant to Fed. R. Civ. P. 12 (b)(6), on the grounds that the Amended Complaint, and the Complaint before it, at most state a claim for aiding and abetting manipulation, which the Supreme Court has recently ruled is not actionable under § 10(b) of the Exchange Act. *See Central Bank of Denver v. First Interstate Bank of Denver, N.A.*, 114 S. Ct. 1439, 1448 (1994). In short, he argues that because he did not control the transactions at issue, he is not a primary violator of § 10(b).

There is no aiding and abetting liability under § 10(b) of the Exchange Act, 15 U.S. C. § 78j(b) . *See Central Bank of Denver,* 114 S. Ct. at 1448. Accordingly, in the wake of *Central Bank,* courts are forced to "sharpen the often murky distinction between primary and derivative liability under § 10(b)." Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation* 1107 (3d ed. 1995). This motion, therefore, presents the issue of whether Romano "employed a manipulative device" under the Exchange Act, when he executed trades at the direction of D'Onofrio, who in turn was directing and controlling trading in USE stock, and using undisclosed nominees to effect matched orders and wash sales. Because Romano did not "employ" a manipulative device, but merely executed elements of the manipulative trades of D'Onofrio, he cannot be held liable as a primary violator under the Exchange Act.

"Manipulative" is "virtually a term of art when used in connection with securities markets." *Ernst & Ernst,* 425 U.S. at 199. "The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977). As alleged in the Amended Complaint, Romano's involvement

---

same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale/purchase of such security." *Ernst & Ernst v. Hochfelder*, 425 U.S.185, 205 n.25 (1976).

consisted of following directions from D'Onofrio in carrying out buy or sell orders. In addition, Romano bought and sold USE stock for the accounts of Castle. These activities do not constitute employing a manipulative device because Romano did not himself make wash sales, match orders, or use undisclosed nominees to artificially affect the price of securities. *See Ernst & Ernst,*. 425 U.S. at 199 (manipulation "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities"); 9 Louis Loss & Joel Seligman, *Securities Regulation* 4018 (3d ed. 1992) (noting that scienter requirement may be redundant as applied to first and third clauses of Rule 10b-5 in light of words "defraud" and "deceit", but not as applied to second clause). Romano bought from and sold to parties who were unrelated to himself and Castle. Even if Romano knew that those parties were D'Onofrio and undisclosed nominees of D'Onofrio, and hence knew that D'Onofrio was manipulating USE stock, he did not himself manipulate USE stock because he did not himself have a manipulative purpose. *Cf. United States v. Mulheren,* 938 F.2d 364, 368 (2d Cir. 1991) ("[W)e will assume, without deciding on this appeal, that an investor may lawfully be convicted under Rule 10b-5 where the purpose of the transaction is solely to affect the price of a security. The issue then becomes one of [the investor's] subjective intent."); Daniel R. Fischel & David J. Ross, Should *the Law Prohibit "Manipulation" in Financial Markets?,* 105 Harv. L. Rev. 503, 506 (1991) ("[T]here is no objective definition of manipulation—manipulative trades must be defined with respect to the intent of the trader."). Without employing "intentional or willful conduct designed to deceive . . . investors by controlling or artificially affecting the price of securities," *see Ernst & Ernst,* 425 U.S. at 199, Romano cannot be liable for manipulation. The Amended Complaint, at most, alleges that D'Onofrio employed "intentional or willful conduct designed to deceive," and that, knowing this, Romano executed trades in USE stock. These allegations constitute nothing more than

aiding and abetting manipulation, and hence are not actionable under § 10(b) of the Exchange Act. *See Central Bank*, 114 S. Ct. at 1448.

The SEC stresses that D'Onofrio guaranteed to Romano that he would profit from trades in USE stock, by selling stock to Romano at a price lower than the price charged to the buyer (presumably a D'Onofrio nominee), and buying stock from Romano at a price higher than the price Romano had paid the seller. However, the fact that Romano had a motive to execute trades on D'Onofrio's direction does not render Romano a manipulator, it merely provides proof that Romano knew of D'Onofrio's manipulations. *Cf. Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994) (pleading requirements of Fed. R. Civ. P. 9(b) satisfied where plaintiff alleges facts to show that defendant had both motive and opportunity to commit fraud). D'Onofrio's pricing of trades so as to guarantee Romano a profit does not render Romano's execution of trades, that he did not himself employ to manipulate, manipulative.

Because the Court finds that plaintiff has failed to state a claim in its third claim for relief, the Court need not address Romano's alternative ground for his motion with respect to the third claim for relief—that plaintiff has failed to plead with particularity as required by Fed. R. Civ. P. 9(b).

In addition, the Court denies leave to replead this claim, on the grounds that any repleading would be futile. *See In re American Express Co. Shareholder Litig.*, 39 F-3d 395, 402 (2d Cir. 1994). Plaintiff has attempted to plead a manipulation claim against Romano twice, and it appears that the facts as alleged support no more than aiding and abetting manipulation by Romano. Repleading will not be able to recast this aiding and abetting as primary liability.

II. *Romano's Motion to Dismiss Sixth Claim Based on Fed. R. Civ. P. 9(b)*

The sixth claim for relief alleges that Romano violated Rule 10b-6, 17 C.F.R. § 240.10b-6, by purchasing or bidding for a

security before his participation in that security's distribution ceased. Romano moves to dismiss this claim for failure to satisfy the pleading requirements of Fed. R. Civ. P. 9(b).

The Amended Complaint has cured the defect of the Complaint, in that it has alleged that (a) Romano was a participant in the distribution, and (b) he purchased USE's stock (c) before his participation in the distribution ended. In particular, the Amended Complaint states that 46,000 units of Windfall Capital Corporation's ("Windfall") initial offering of 1,000,0000 units were purchased by Castle nominees. *See* Amended Complaint ¶¶ 54, 57. Windfall subsequently merged with USE, and the surviving corporation was named USE. Thus the participation of Romano in the distribution of USE stock, as a registered representative of Castle, did not cease until the shares obtained by Castle nominees in the initial offering came to rest with the public. *See R.A. Holman & Co., Inc. v. S.E.C.*, 366 F.2d 446, 450 (2d Cir. 1966), *cert. denied*, 389 U.S. 991 (1967); *S.E.C. v. Kimmes*, 799 F. Supp. 852, 859 (N.D. Ill. 1992). Accordingly, Romano's purchase of those shares into Castle's trading account between September 8, 1989 and September 11, 1989, *see* Amended Complaint ¶¶ 73, 135(c), violated Rule 10b-6, and Romano's scienter of the violation of Rule 10b-6 is adequately pleaded by Amended Complaint ¶ 74. The SEC has pleaded, with the requisite particularity, a violation of Rule 10b-6 by Romano.

## CONCLUSION

For the reasons stated above, plaintiff's third claim for relief—that Romano violated § 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder by manipulating the market for USE stock—is DISMISSED for failure to state a claim. Defendant's motion to dismiss plaintiff's sixth claim for relief—that Romano violated § 10(b) of the Exchange Act and Rule 10b-6 promulgated thereunder by purchasing or bidding on a security while he was a participant in the distribution of that security—is DENIED.

SO ORDERED.

New York, New York
June 18, 1996

PETER K. LEISURE
U.S.D.J.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

---

94 Civ. 6608 (PKL)

---

SECURITIES AND EXCHANGE COMMISSION,

*Plaintiff,*

—against—

U.S. ENVIRONMENTAL, INC., et al.,

*Defendants.*

---

ORDER

LEISURE, *District Judge*:

On June 18, 1996, this Court issued a Memorandum Order in the above captioned action. Page 8 thereof is HEREBY AMENDED to add the following above the Conclusion:

CERTIFICATION FOR INTERLOCUTORY APPEAL

Pursuant to 28 U.S. C. § 1292(b), a district court may certify an order for interlocutory review if it finds that the order "involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation." 28 U.S.C. § 1292(b).

The issue of what level of scienter is required before a person trading in securities can be said to manipulate the securities is the important question of law considered in this Memorandum Order. The Amended Complaint alleged knowledge or recklessness on the part of defendant Romano, whereas this Court has ruled that intent was required before a trade could be designated manipulative. *See* Daniel R. Fischel & David J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 Harv. L. Rev. 503, 506 (1991) ("[T]here is no objective definition of manipulation—manipulative trades must be defined with respect to the intent of the trader."). This question is controlling because based on the Court's ruling on this question of law, the Court dismissed plaintiff's third claim for relief against Romano.

In addition, the Court finds that there is "substantial ground for difference of opinion" because the recent decision by the Supreme Court, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 114 S. Ct. 1439 (1994), requires lower courts to refine the distinction between primary and secondary violations of the securities laws. Part of this refinement is the distinction between different types of Rule 10b-5 violations, and the scienter required for each. Specifically, the Court has ruled that the scienter required for liability based on false statements is different from the scienter required for liability based on manipulations, and therefore has ruled that where, as here, manipulation is the basis of the claim, manipulative intent, and not mere knowledge or recklessness, is required before Rule 10b-5 is violated. *Compare San Leandro Emergency Medical Group Profit Sharing Plan v. Philip Morris Companies, Inc.*, 75 F.3d 801, 813 (1996) (to state claim, plaintiff must plead that defendant made a false statement of material fact or omitted a material fact with knowledge or recklessness). Because the *Central Bank* decision is quite recent, there is substantial ground for difference of opinion regarding how to refine the distinction between primary and secondary violations of the securities laws.

Finally, immediate appellate review may materially advance the ultimate termination of this litigation. The trading in USE stock is at the heart of this litigation, and the discovery to be taken regarding this trading may be curtailed by the Court's ruling regarding Romano's participation. Therefore, if the Court's ruling were reversed, the Court would face the possibility of new discovery and retrial. If the Court's ruling were affirmed, the prospects for resolving the dispute by settlement would be greatly enhanced.

Finally, in the absence of an immediate appeal, the Court's ruling will likely be relied on by other courts considering the implications of *Central Bank*, thus proliferating the effect of the Court's ruling, regarding which there is substantial ground for difference of opinion. Speedy review of the Court's ruling by the Court of Appeals would likely conserve judicial resources by clarifying this developing area of the law.

Accordingly, the Court certifies this Memorandum Order for interlocutory appeal pursuant to § 1292(b).

SO ORDERED.

New York, New York
August 6, 1996

PETER K. LEISURE
U.S.D.J.

Supreme Court, U.S.
FILED
APR 12 1999
CLERK

(2)

No. 98-1271

# In the Supreme Court of the United States

OCTOBER TERM, 1998

JOHN ROMANO, PETITIONER

*v.*

SECURITIES AND EXCHANGE COMMISSION

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

SETH P. WAXMAN
*Solicitor General*
*Counsel of Record*
*Department of Justice*
*Washington, D.C. 20530-0001*
*(202) 514-2217*

HARVEY J. GOLDSCHMID
*General Counsel*
DAVID M. BECKER
*Deputy General Counsel*
JACOB H. STILLMAN
*Solicitor*
CHRISTOPHER PAIK
*Special Counsel*
*Securities and Exchange Commission*
*Washington, D.C. 20549*

12 pp

## QUESTION PRESENTED

Whether a stock trader employed by a broker-dealer is a primary violator of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), rather than only an aider and abettor, when the trader, acting at the direction of the instigator of a market manipulation, executes trades that he knows are manipulative.

## TABLE OF CONTENTS


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Statement | 2 |
| Argument | 7 |
| Conclusion | 9 |


## TABLE OF AUTHORITIES

Cases:


| | |
|---|---|
| *Black* v. *Cutter Labs.*, 351 U.S. 292 (1956) | 9 |
| *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327 (1967) | 8 |
| *Central Bank* v. *First Interstate Bank*, 511 U.S. 164 (1994) | 4, 6 |
| *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) | 4, 8 |
| *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251 (1916) | 8 |
| *Reece* v. *Georgia*, 350 U.S. 85 (1955) | 7 |
| *Sante Fe Indus.* v. *Green*, 430 U.S. 462 (1977) | 8 |
| *Virginia Military Inst.* v. *United States*, 508 U.S. 946 (1993) | 8 |
| *Washington* v. *Washington State Commercial Passenger Fishing Vessel Ass'n*, 443 U.S. 658 (1979) | 7 |


Statutes and regulation:


| | |
|---|---|
| Securities Act of 1933, § 17(a), 15 U.S.C. 77q(a) | 3, 4 |
| Securities Exchange Act of 1934, § 10(b), 15 U.S.C. 78j(b) | 3, 4, 5, 7, 8, 9 |
| 28 U.S.C. 1292(b) | 5 |
| 17 C.F.R. 240.10b-5 | 3, 4 |

Miscellaneous:

Page

Restatement (Second) of Torts (1965) ..... 9

# In the Supreme Court of the United States

OCTOBER TERM, 1998

No. 98-1271

JOHN ROMANO, PETITIONER

*v.*

SECURITIES AND EXCHANGE COMMISSION

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 155 F.3d 107. The opinion of the district court granting in part petitioner's motion to dismiss for failure to state a claim (Pet. App. 17a-23a) is reported at 929 F. Supp. 168. The order of the district court certifying its dismissal order for interlocutory appeal (Pet. App. 24a-26a) is unreported.

### JURISDICTION

The judgment of the court of appeals was entered on August 28, 1998. A petition for rehearing was denied on November 13, 1998 (Pet. App. 15a-16a). The petition for a writ of certiorari was filed on February 5, 1999.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. In 1994, the Securities and Exchange Commission (Commission) brought this civil law enforcement action against petitioner and others, alleging violations of various provisions of the federal securities laws. Pet. App. 5a; Gov't C.A. App. 1. In its amended complaint, the Commission alleges, *inter alia*, that petitioner and others entered into an agreement to manipulate upward the price of the stock of U.S. Environmental, Inc. (USE). Gov't C.A. App. 13-14, 30-37, 45-46, 51-53; Pet. App. 3a-5a.

Specifically, the amended complaint alleges that petitioner was employed as a securities trader by Castle Securities Corp. (Castle), a securities broker-dealer. Gov't C.A. App. 16, 18; Pet. App. 3a. Castle agreed to participate in a scheme whereby it and others, including petitioner, would manipulate the price of USE stock. Gov't C.A. App. 25-26, 30-31; Pet. App. 3a. At the direction of stock promoter Mark D'Onofrio (D'Onofrio), certain of the participants in the scheme traded USE shares among themselves for the purpose of creating the appearance of an actual market for the stock, thereby raising the stock's price. Gov't C.A. App. 30-31, 33-36; Pet. App. 3a.

As alleged in the amended complaint, petitioner's role in the stock manipulation scheme was to execute, for the other participants, sham trades that he knew had no economic substance. The trades were executed for the purpose of affecting USE's stock price by creating the false appearance of market activity. Gov't C.A. App. 32-33; Pet. App. 3a-5a. In addition, petitioner entered quotations for USE shares on behalf of Castle

at prices specified by D'Onofrio rather than on the basis of actual market activity. Gov't C.A. App. 32; Pet. App. 4a.

The amended complaint further alleges that petitioner knew that the trades he executed, although ostensibly arms'-length trades between Castle and other broker-dealers, were in fact directed on both sides by D'Onofrio. D'Onofrio told petitioner in advance that Castle would be receiving an order from another broker-dealer, and he specified the price at which petitioner was to fill the order. Gov't C.A. App. 33-34; Pet. App. 5a. D'Onofrio supplied petitioner with the USE stock that Castle needed to fill buy orders, giving Castle a discount (and therefore a guaranteed profit); D'Onofrio also purchased USE stock that petitioner had acquired on behalf of Castle, always at a profit to Castle. Gov't C.A. App. 32-33; see Pet. App. 4a.

The amended complaint alleges that the participants in the fraudulent scheme succeeded in manipulating the price of USE stock from $.05 to in excess of $5 per share. Gov't C.A. App. 13, 37. Castle received $175,000 for executing trades at the direction of D'Onofrio and other participants. *Id.* at 40.

2. In the third claim for relief, which is the sole claim currently at issue, the amended complaint alleges that the market manipulation scheme described above violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5. Gov't C.A. App. 51-53. The third claim for relief also alleges that the scheme violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a). Gov't C.A. App. 51-53; Pet. App. 12a-13a.

Petitioner moved to dismiss the third claim for relief for failure to state a claim. Pet. App. 5a-6a. The

district court granted the motion, holding that the allegations in the complaint relating to that claim failed to make out a violation of Section 10(b) and Rule 10b-5. *Id.* at 18a-21a.[1] Relying on this Court's decision in *Central Bank* v. *First Interstate Bank*, 511 U.S. 164 (1994), the district court held that there is no aiding and abetting liability under Section 10(b) and Rule 10b-5. Pet. App. 19a. The district court further held that the allegations in the complaint established only that petitioner was an aider and abettor of the market manipulation scheme, not that he was a primary violator. *Id.* at 19a-21a.

According to the district court, the Commission had alleged only that petitioner had "executed elements of the manipulative trades of D'Onofrio" and that he had "follow[ed] directions from D'Onofrio." Pet. App. 19a-20a. In the district court's view, petitioner "did not himself make wash sales, match orders, or use undisclosed nominees to artificially affect the price of securities."[2] *Id.* at 20a. The district court concluded that, even if petitioner "knew that D'Onofrio was manipulating USE stock, he did not himself manipulate USE stock because he did not himself have a manipulative purpose." *Ibid.*; see also *id.* at 25a ("where, as here,

---

[1] In granting the motion to dismiss the third claim, the district court addressed only Section 10(b) and Rule 10b-5, and did not address Section 17(a), which the Commission relied upon as an alternative basis for the claim. Pet. App. 12a-13a.

[2] "'Wash' sales are transactions involving no change in beneficial ownership. 'Matched' orders are orders for the purchase/sale of a security that are entered with the knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale/purchase of such security." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 205 (1976).

manipulation is the basis of the claim, manipulative intent, and not mere knowledge or recklessness, is required before Rule 10b-5 is violated").

3. The district court certified the dismissal order for interlocutory appeal pursuant to 28 U.S.C. 1292(b). Pet. App. 24a-26a. The court of appeals granted the motion for interlocutory appeal, and reversed. *Id.* at 1a-14a. The court pointed out that the complaint alleged that:

(a) participants other than petitioner, directed by D'Onofrio, "traded USE shares among themselves for the purpose of creating the appearance of an actual market for trading USE shares";

(b) petitioner participated in the market manipulation scheme by, *inter alia*, "effecting directed and controlled trades" and "effecting wash sales and matched orders";

(c) petitioner "agreed to execute trades as directed by D'Onofrio, and also agreed to move, or adjust, the price Castle quoted for USE shares at D'Onofrio's direction"; and

(d) during the manipulation, D'Onofrio alerted petitioner in advance that Castle would be receiving orders for USE stock from specific parties and told petitioner how to fill the orders, in terms of number of shares and price.

*Id.* at 3a-5a (internal quotation marks omitted).

In view of the facts alleged in the complaint, the court held that petitioner could be liable as a primary violator of Section 10(b). Pet. App. 3a. While recogniz-

ing that this Court held in *Central Bank* that "civil liability under § 10(b) applies only to those who 'engage in the manipulative or deceptive practice,' but not to those 'who aid and abet the violation,'" the court of appeals concluded that petitioner's conduct fell "well within the boundaries of primary liability." *Id.* at 8a (quoting *Central Bank*, 511 U.S. at 167). In *Central Bank*, the court explained, the defendant—an indenture trustee alleged to have conducted inadequate oversight—had concededly neither made a material misstatement nor committed a manipulative act. *Id.* at 11a (citing *Central Bank*, 511 U.S. at 177). In the present case, by contrast, "[petitioner] himself 'commi[tted] a manipulative act,' by effecting the very buy and sell orders that manipulated USE's stock upward." *Id.* at 12a (citing *Central Bank*, 511 U.S. at 177). The court of appeals observed that "if the trader who executes manipulative buy and sell orders is not a primary violator, it is difficult to imagine who would remain liable after *Central Bank*." *Id.* at 11a.

The court viewed it as "of no relevance that D'Onofrio, not [petitioner], masterminded the USE stock manipulation." Pet. App. 12a. *Central Bank*, the court explained, made clear that secondary actors in a securities fraud scheme can be liable as primary violators. *Ibid.* (citing *Central Bank*, 511 U.S. at 191). Similarly, the court of appeals disagreed with the district court's conclusion that petitioner "did not himself manipulate USE stock because he did not himself have a manipulative purpose." *Id.* at 8a; see also *id.* at 20a. Rather, petitioner's conduct, as alleged in the complaint, amounted to manipulation of USE stock "even if [petitioner] did not share [D'Onofrio's] specific overall purpose to manipulate the market." *Id.* at 3a; see also *id.* at 8a.

Addressing the adequacy of the complaint's allegations of scienter, the court of appeals found it sufficient that the complaint alleged that petitioner "intentionally engaged in manipulative conduct" and "executed trades that he knew were for a manipulative purpose." Pet. App. 9a-10a (internal quotation marks omitted). The court also noted that, "although [it] need not rely on this point," the complaint would have been sufficient to make out a Section 10(b) violation even if it had only alleged reckless conduct. *Id.* at 10a.

## ARGUMENT

The decision of the court of appeals is interlocutory, is correct, and does not conflict with any decision of this Court or of any other court of appeals. Review by this Court is unwarranted.

1. In this interlocutory appeal, the court of appeals reversed the district court's holding that the third claim in the Commission's complaint failed to state a claim under Section 10(b). The court of appeals remanded the case for further proceedings, and noted that among the issues left open was petitioner's alternative argument that the third claim should be dismissed for failure to plead fraud with particularity. Pet. App. 13a. The ruling of the court of appeals therefore does not even definitively resolve whether the third claim for relief should be dismissed prior to trial. Moreover, if proceedings on remand were ultimately to result in a final judgment against petitioner on that claim, petitioner would be free to seek review of that final judgment, and could seek to bring his present contention before this Court by way of a petition for a writ of certiorari. See, *e.g.*, *Washington* v. *Washington State Commercial Passenger Fishing Vessel Ass'n*, 443 U.S. 658, 672 n.19 (1979); *Reece* v. *Georgia*, 350 U.S. 85, 87 (1955). Except

in extraordinary circumstances not present here, this Court's practice is to decline to exercise certiorari jurisdiction over cases that are in an interlocutory posture. See, *e.g.*, *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967) (per curiam); *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916) ("[E]xcept in extraordinary cases, the writ [of certiorari] is not issued until final decree. * * * [The absence of a final judgment] of itself alone furnishe[s] sufficient ground for the denial of [an] application."); see also *Virginia Military Inst.* v. *United States*, 508 U.S. 946, 946 (1993) (opinion of Scalia, J., respecting denial of petition for writ of certiorari).

2. In any event, the ruling below is correct. The complaint alleges that petitioner knowingly participated in a scheme to manipulate the price of USE stock, and that his role in that scheme was to personally execute manipulative sham trades that were essential to the functioning of the scheme. The court of appeals rightly concluded that this conduct falls "well within the boundaries of primary liability" under Section 10(b). Pet. App. 8a. Although petitioner contends that a trade is not manipulative unless it is "intended to mislead investors by artificially affecting market activity," Pet. 13 (emphasis omitted) (quoting *Sante Fe Indus.* v. *Green*, 430 U.S. 462, 476 (1977)), the complaint in this case alleges that the trades at issue were so intended and that petitioner knew that when he executed them. Petitioner cites no case holding that more is required to establish liability as a primary violator of Section 10(b). See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976) ("[t]he words 'manipulative or deceptive' * * * strongly suggest that § 10(b) was intended to proscribe *knowing or intentional* misconduct") (emphasis added);

cf. Restatement (Second) of Torts § 8A (1965) ("If the actor knows that the consequences are certain, or substantially certain, to result from his act, and still goes ahead, he is treated by the law as if he had in fact desired to produce the result.") (cited at Pet. App. 10a).[3]

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
*Solicitor General*

HARVEY J. GOLDSCHMID
*General Counsel*
DAVID M. BECKER
*Deputy General Counsel*
JACOB H. STILLMAN
*Solicitor*
CHRISTOPHER PAIK
*Special Counsel*
*Securities and Exchange Commission*

APRIL 1999

---

[3] Petitioner also seeks review of the court of appeals' remark that an allegation of recklessness can support a Section 10(b) claim. See Pet. 14-16; Pet. App. 10a (noting that eleven circuits have so held). The court of appeals expressly noted, however, that it was not relying on such a theory in this case. Pet. App. 10a. The correctness of the court of appeals' observation is therefore not properly presented for this Court's review. See, *e.g.*, *Black* v. *Cutter Labs.*, 351 U.S. 292, 297 (1956) ("This Court, however, reviews judgments, not statements in opinions.").

No. 98-1271

Supreme Court, U.S.
FILED
APR 28 1999
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1998

JOHN ROMANO,

*Petitioner,*

—v.—

SECURITIES AND EXCHANGE COMMISSION,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## REPLY BRIEF FOR PETITIONER

RONALD E. DEPETRIS
*Counsel of Record*
DEPETRIS & BACHRACH
*Attorneys for Petitioner*
620 Fifth Avenue
New York, New York 10020
(212) 332-6030

1098

## QUESTIONS PRESENTED

1. Is manipulative intent or purpose an essential element of a claim of primary liability for market manipulation under Section 10(b) of the Securities Exchange Act of 1934?

2. Does recklessness satisfy the scienter requirement for imposition of primary liability for market manipulation under Section 10(b) of the Securities Exchange Act of 1934?

## TABLE OF CONTENTS

PAGE

QUESTIONS PRESENTED ..... i

TABLE OF CONTENTS ..... ii

TABLE OF AUTHORITIES ..... iii

STATEMENT ..... 1

ARGUMENT ..... 2

CONCLUSION ..... 7

## TABLE OF AUTHORITIES

**Cases:**

PAGE

*Black v. Cutter Laboratories*, 351 U.S. 292, 76 S.Ct. 824 (1956) ..... 6

*Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S.Ct. 1439 (1994) ..... 4, 7

*Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct 1375 (1976) ..... 6, 7

*Oklahoma Tax Commission v. Citizen Bank Potawatomi Indian Tribe of Oklahoma*, 498 U.S. 505, 111 S.Ct. 905 (1991) ..... 6

*Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S.Ct. 1292 (1977)..... 6, 7

**Miscellaneous:**

Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction 2d* § 4036 (2d Ed. 1988) 3, 4

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1998

**No. 98-1271**

JOHN ROMANO,

*Petitioner,*

—against—

SECURITIES AND EXCHANGE COMMISSION,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## REPLY BRIEF FOR PETITIONER

### STATEMENT

Petitioner John Romano ("Romano") submits this reply brief in support of his Petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Second Circuit. The Court of Appeals reversed the memorandum order dismissing the claim of market manipulation against Romano issued by the United States District Court for the Southern District of New York. As fully set forth in the Petition, this case presents important questions concerning the essential elements of a claim of primary liability for market manipulation under Section 10(b) of the Securities Exchange Act of 1934.

Relying on the meaning of the term manipulation as defined in decisions of the Supreme Court of the United States, the district court ruled that manipulative intent, not mere knowledge or recklessness, was required. Accordingly, the district court dismissed the market manipulation claim against the trader Romano because the Amended Complaint alleged that in effecting the trades prearranged by the stock promoters Romano acted knowingly or recklessly, but did not allege that he acted with a manipulative intent. Pet. App. 19a-20a, 25a.

In its decision reversing the district court, the Second Circuit Court of Appeals ruled that a stock trader may be held primarily liable for manipulation of the market even though the trader did not act with a manipulative purpose or intent and did not share the manipulative purpose or intent of the principal defendants, the stock promoters. The Court of Appeals reached this rather remarkable conclusion without citing a single case holding that manipulative purpose or intent is not an essential element of a manipulation claim, and without addressing the decisions by this Court that belie the proposition that a person may be liable for market manipulation without regard to manipulative intent or purpose. The Court of Appeals ruled alternatively that knowledge or recklessness constituted sufficient scienter to state a claim of liability under § 10(b) for market manipulation. Pet. App. 3a, 7a, 9a-10a.

Respondent Securities and Exchange Commission ("SEC") has submitted a brief in opposition to the Petition. However, as we show below, the arguments made in respondent's brief in opposition are without merit.

## ARGUMENT

1. Respondent SEC argues that the petition for a writ of certiorari should be denied because the decision of the Court of Appeals is interlocutory. Respondent asserts that "[e]xcept in extraordinary circumstances not present here, this Court's

practice is to decline to exercise certiorari jurisdiction over cases that are in an interlocutory posture." Respondent's Brief, at pp.7-8. This argument is of no avail here for several reasons.

First, this is an interlocutory appeal pursuant to the provisions of 28 U.S.C. § 1292(b). The district court certified its order for interlocutory review on the ground that the order "involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation," 28 U.S.C. § 1292(b). Pet. App. 24a-26a. And the Second Circuit Court of Appeals exercised its discretion under § 1292(b) to hear and decide the interlocutory appeal. Contrary to respondent's suggestion, this "Court regularly reviews cases decided in the courts of appeals on appeal under 28 U.S.C.A. § 1292(b) without further comment on its own jurisdiction. [citing numerous cases]." Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction 2d* § 4036, at pp. 28-29, n.50(2d Ed. 1988), and Supp., at p. 8 (1999).

Second, respondent's argument ignores the nature of the issues presented here. As the district court stated in certifying the order for interlocutory review, this appeal involves the "important" and "controlling" question of law as to "what level of scienter is required before a person trading in securities can be said to manipulate the securities". Pet. App. 25a. As the district court further stated in its certification for interlocutory appeal:

> The Amended Complaint alleged knowledge or recklessness on the part of defendant Romano, whereas this Court has ruled that intent was required before a trade could be designated manipulative. . . . Specifically, the Court . . . has ruled that where, as here, manipulation is the basis of the claim, manipulative intent, and not mere

> knowledge or recklessness, is required before Rule 10b-5 is violated.

Pet. App. 25a.

Thus, the issue here as to the requisite level of scienter (whether specific intent to manipulate, knowledge, or recklessness) clearly involves an important and clear-cut issue of law. Moreover, that issue of law is controlling and fundamental to the further conduct of this case. Pet. App. 25a-26a. Manifestly, that is the situation where, as here, the critical manipulation claim against Romano was dismissed by the district court, and the ruling of the court of appeals has reversed the dismissal and required further proceedings on the claim in the district court. See Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction 2d* § 4036, *supra*, at pp. 30-32, and n.57.

Third, the SEC's argument concerning the interlocutory posture of the case is substantially undermined by the position that it took in the Brief For The United States As *Amicus Curiae* filed in this Court on petition for a writ of certiorari in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, No. 92-854 (October Term 1992). In *Central Bank*, the Tenth Circuit Court of Appeals had held that recklessness was sufficient scienter to hold a secondary actor liable for aiding and abetting the primary violator. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 168-69, 114 S.Ct. 1439, 1443-44 (1994). This Court invited the Solicitor General to express the views of the United States on petition for a writ of certiorari. That petition also involved interlocutory review: the Court of Appeals had reversed the decision of the district court granting summary judgment dismissing the aiding and abetting claim against Central Bank. *Id.*

Although the government believed that the Court of Appeals' decision was correct, it agreed with petitioner Central Bank that the scienter issue warranted review by this

Court. With respect to the interlocutory aspect of the appeal, the government took a position that is at odds with the "exceptional circumstances" position enunciated in the case at bar. The government's brief stated:

> We recognize that the interlocutory nature of the decision below militates against immediate review by this Court. *See, e.g., Brotherhood of Locomotive Firemen v. Bangor & A.R.R.*, 389 U.S. 327, 328 (1967) (per curiam); *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916); *American Construction Co. v. Jacksonville, T. & K.W. Ry.*, 148 U.S. 372, 384 (1893). Nonetheless, it is well-established that "where * * * there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed despite its interlocutory status." R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 225 (6th ed. 1986) (citing cases). The issue of law presented in this case is not likely to be sharpened by factual elaboration at trial, and the question is clearly one that would otherwise qualify as a basis for certiorari.

Brief For The United States As *Amicus Curiae*, at pp. 17-18. And as noted in Romano's Petition, at p. 15, this Court granted certiorari to review two important questions presented (including the scienter issue), and decided the case without reaching the scienter question because it held that a private plaintiff may not maintain an aiding and abetting claim under Section 10(b).[1]

---

[1] Respondent argues in footnote 3 of its brief that the second question presented in Romano's Petition (whether recklessness satisfies the scienter requirement for imposition of primary liability for market manipulation) is not properly presented for this Court's review because the statement by the Court of Appeals that recklessness is sufficient was only a "remark" or "observation" that it was not relying on for its decision. Respondent is mistaken. While the Court of Appeals concluded its opinion with a few "observations", Pet. App. 12a, the ruling concerning recklessness was in a prior part of the opinion. Pet. App. 10a. Moreover, although commenting that "we need not rely on this point," *id.*, the Court

2. Respondent SEC is also less than forthright with respect to the conflict between the decision of the Court of Appeals (namely, that petitioner Romano can be held liable on the market manipulation claim as a primary violator for effecting the stock promoters' trades if he had knowledge that the stock promoters intended to manipulate the market, even if he himself did not have or share that manipulative intent), and prior decisions of this Court. As shown in Romano's Petition, at pp. 12-13, those Supreme Court decisions make it clear that manipulation is a term of art that requires a specific intent to manipulate market activity or the price of securities. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476, 97 S.Ct. 1292, 1302 (1977) (trading practices "that are intended to mislead investors by artificially affecting market activity"); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199, 96 S.Ct. 1375, 1384 (1976) ("intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities").

Respondent appears to argue that the Court of Appeals' decision that the secondary actor Romano can be held liable without a specific intent to manipulate does not conflict with this Court's decisions because the stock promoters are alleged to have acted with the requisite specific intent to manipulate market activity and the prices of securities. However, respondents do not offer any rationale to support the argument that

---

of Appeals proceeded to decide the point: "we also note that the complaint's claim that Romano recklessly participated in the manipulation also alleges sufficient scienter. [Citations omitted.]" Pet. App. 10a. *See Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 498 U.S. 505, 512, 111 S.Ct. 905, 911 (1991) (Supreme Court proceeds to decide question of sovereign immunity after commenting that "[w]hile neither of these courts [district court and court of appeals] need have reached that question, they both did"). Respondent's citation of *Black v. Cutter Laboratories*, 351 U.S. 292, 297, 76 S.Ct. 824, 827 (1956) is inapposite because it involves a state court decision, review of which is not undertaken where the judgment rests on an independent state ground. *Id.* ("we should not pass on federal questions discussed in the opinion where it appears that the judgment rests on adequate state grounds").

a secondary actor can be held liable as a primary violator with a lesser scienter requirement (knowledge or recklessness) than is applicable to the primary actor (specific intent to manipulate); the *Santa Fe Industries* and *Ernst & Ernst* decisions of this Court provide no support for such a distinction; and the argument that the intent to manipulate requirement of primary liability can be dispensed with for a secondary actor is belied by the decision of this Court in *Central Bank* (a secondary actor who employs a manipulative device may be liable as a primary violator, assuming *"all* of the requirements for primary liability under Rule 10b-5 are met", 511 U.S. at 191, 114 S.Ct. at 1455).

## CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: April 28, 1999

Respectfully submitted,

RONALD E. DEPETRIS
*Counsel of Record*
DEPETRIS & BACHRACH
*Attorneys for Petitioner*
620 Fifth Avenue
New York, New York 10020
(212) 332-6030